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# In the Supreme Court of the United States

OCTOBER TERM, 1941

CARTER H. HARRISON, INDIVIDUALLY AND AS COLLECTOR OF INTERNAL REVENUE, FIRST COLLECTION DISTRICT OF ILLINOIS, PETITIONER

*v.*

THE NORTHERN TRUST COMPANY AND MARY E. KAUFMAN, EXECUTORS UNDER THE LAST WILL AND TESTAMENT OF HENRY M. WOLF, DECEASED

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT**

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of Carter H. Harrison, individually and as Collector of Internal Revenue for the First Collection District of Illinois, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit, entered in the above case on February 27, 1942, affirming the decision of the District Court of the United States for the Northern District of Illinois.

## OPINIONS BELOW

The District Court rendered no opinion. The opinion of the Circuit Court of Appeals (R. 217–220) is reported in 125 F. (2d) 893.

## JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 27, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Whether, under the provisions of Section 303 (a) (3) of the Revenue Act of 1926 as amended by Section 807 of the Revenue Act of 1932, the amount to be deducted from decedent's gross estate on account of decedent's bequest of his residuary estate to charity is the actual amount of such bequest, after payment of federal estate taxes, or what would have been the amount if there had been no federal estate taxes.

## STATUTES AND REGULATIONS INVOLVED

Section 807 of the Revenue Act of 1932, c. 209, 47 Stat. 169, provides as follows:

> Sections 303 (a) (3) and 303 (b) (3) of the Revenue Act of 1926 are amended by inserting after the first sentence of each a new sentence to read as follows:

"If the tax imposed by section 301, or any estate, succession, legacy, or inheritance taxes, are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this paragraph, then the amount deductible under this paragraph shall be the amount of such bequests, legacies, or devises reduced by the amount of such taxes."

The other statutory provisions and the regulations involved appear in Appendix A, *infra*, pp. 10–12.

## STATEMENT

Respondents as executors of the last will and testament of Henry M. Wolf brought this suit to recover an alleged overpayment of federal estate taxes. The District Court entered judgment for respondents in the amount of $149,416.92 (R. 211–212) and the Circuit Court of Appeals affirmed (R. 220–221).

The facts were stipulated (R. 71–81) and may be summarized as follows:

Testator, a resident of Chicago, Illinois, died on June 4, 1935, leaving a gross estate of $4,238,805.97. His will contained a number of specific bequests to individuals as well as specific bequests to charities aggregating $1,570,696.74, and a bequest of his residuary estate to four named charitable or-

ganizations. Except for a direction that all inheritance, legacy, succession, and estate taxes on certain of the bequests to individuals should be paid out of the general estate, the will contained no provision as to the payment of federal or state taxes. (R. 72–73, 8–22.)

Upon final audit of the estate tax return filed by respondents, the Commissioner of Internal Revenue found a total tax of $459,879.57. In computing the net estate for tax the Commissioner allowed a deduction in the full amount of the specific bequests to charities, and a deduction of $3,223.51 on account of the bequest of the residuary estate to charities. The latter amount represents the amount of the residuary estate actually receivable by the residuary charitable legatees after payment of the federal estate tax from the general estate as computed by the Commissioner. (R. 74–78.)

Respondents paid the tax assessed by the Commissioner under protest and thereafter filed a claim for refund in the amount of $119,069.43 with interest. This amount is the difference between the tax assessed by the Commissioner plus interest thereon paid by respondents and $342,744.60, which is the tax computed according to respondents' theory that the amount properly deductible on account of the bequest of the residuary estate to charity is the full amount which would have been receivable under the bequest in the absence of any federal estate tax. The claim for refund was rejected by

the Commissioner and this suit followed. (R. 78–91.)

By stipulation of the parties it is conceded that the suit should be dismissed with costs to respondents if the Commissioner was correct in construing Section 807 of the Revenue Act of 1932 to limit the deduction on account of the bequest of the residuary estate to charity to the amount actually receivable under the bequest after payment of the federal estate tax. It is also conceded that if Section 807 is inapplicable, as respondents contend, respondents are entitled to recover the amount claimed by them ($119,069.43) with interest. (R. 79–80.) Apart from the question of statutory construction, there is, therefore, no question as to the accuracy of the respective computations of tax made by the Commissioner and by respondents.

### REASON FOR GRANTING THE WRIT

The decedent bequeathed the residue of his estate for charitable purposes, and the question presented relates to the computation of the charitable deduction on account of that bequest. After subtracting all other bequests from the decedent's assets there remained a residue of over $400,000, and it is that residue which the executors seek to deduct in full. However, the payment of estate taxes with respect to the various specific bequests made by the decedent absorbed the great bulk of that residue, with the consequence that only a relatively small amount was actually available for distribution to the chari-

table donees. It is the Government's position that only the net amount actually distributable to the residuary legatees may be deducted.

The situation is substantially identical with that presented in *Edwards* v. *Slocum*, 264 U. S. 61, in which the issue was decided against the Government under the Revenue Act of 1918. Thereafter, by Section 807 of the Revenue Act of 1932, Congress undertook to overcome the result of *Edwards* v. *Slocum*, and specifically provided:[1]

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[1] The report of the House Ways and Means Committee accompanying the bill which became the Revenue Act of 1932 makes it clear that these provisions were intended to reverse the rule of *Edwards* v. *Slocum*. H. Rep. No. 708, 72d. Cong., 1st Sess., pp. 49–50. See Appendix B, *infra*, pp. 13–14.

Moreover, certain earlier legislative history shows that these provisions were intended to vitiate the effect of *Edwards* v. *Slocum*. That decision was rendered on February 18, 1924, and was called to the attention of the Senate Committee which was then considering the Revenue Bill of 1924; and when that bill was reported out it contained a sentence substantially identical with the provisions involved herein. See H. R. 6715 (Calendar No. 388), 68th Cong., 1st Sess., p. 149. The report of the Senate Committee (S. Rep. No. 398, 68th Cong., 1st Sess., p. 35) as well as the Conference Report (H. Rep. No. 844, 68th Cong., 1st Sess., pp. 25–26) made it clear that the new provisions were intended to permit as a deduction only the amount actually distributable to the charitable donees. See Appendix B, *infra*, p. 15. Although those provisions were enacted as part of Section 303 (a) of the Revenue Act of 1924, they were subsequently repealed as of June 2, 1924, by Section 323 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9. They were thereafter restored to the estate tax law by Section 807 of the Revenue Act of 1932, here involved.

SEC. 807. DEDUCTION OF BEQUESTS, ETC. TO CHARITY.

Sections 303 (a) (3) and 303 (b) (3) of the Revenue Act of 1926 are amended by inserting after the first sentence of each a new sentence to read as follows:

"If the tax imposed by section 301, or any estate, succession, legacy, or inheritance taxes, are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this paragraph, then the amount deductible under this paragraph shall be the amount of such bequests, legacies, or devises reduced by the amount of such taxes."

It is not disputed that by the broad sweep of these provisions Congress intended to do away with the result reached in *Edwards* v. *Slocum*, whereby the charitable deduction allowed was considerably in excess of the actual amount payable to the charitable donee.[2] The decision of the court

[2] Indeed, under that decision it was possible to obtain a charitable deduction even though *no* amount was distributable to the charitable donee. For example, a decedent with assets of $11,000,000 could make specific bequests of $10,000,000 to noncharitable legatees, and then provide that the residue go to specified charities. But the residue in that situation would be completely absorbed by the estate tax, so that there would remain no residue for distribution. Yet, under *Edwards* v. *Slocum*, there would be a deduction of

below, however, defeats the very object which these provisions were designed to achieve. It rests upon refinements wholly contrary to the congressional purpose. The court below holds that under Illinois law the estate tax was a "charge" upon the entire estate and not merely the residue, and that therefore it was not payable "out of" the residue within the meaning of the Illinois law. But the plain fact is that regardless of whether it may be a "charge" against the entire estate in the sense of a lien or otherwise, it was nevertheless properly paid pursuant to Illinois law in such manner as to reduce the amount distributable to the residuary donees, with the consequence that the residuary bequests bore the economic burden; it was therefore paid "out of" the residue within the meaning of Section 807.

The decision is of considerable fiscal importance to the Government. The Treasury advises us that although it has not been able to make a complete survey of all pending estate tax cases, it in fact knows of a number of pending cases raising the identical issue involving over $22,000,000 in taxes, and it estimates that a complete survey would dis-

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$1,000,000. The decision thus provided a facile means of estate tax avoidance by permitting the decedent to carve up the estate in such manner as to leave a "residue" substantially equal to the anticipated tax and then make the meaningless bequest of the "residue" to charity.

close about 2,000 cases with an aggregate estate tax liability of approximately $50,000,000 which would turn upon the issue herein.

In view of the importance of the question, it is respectfully submitted that the petition should be granted.

CHARLES FAHY,
*Solicitor General.*

MAY 1942

## APPENDIX A

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 303. For the purpose of the tax the value of the net estate shall be determined—

(a) In the case of a resident, by deducting from the value of the gross estate—

* * * * *

(3) The amount of all bequests, legacies, devises, or transfers, to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. The amount of the deduction under this paragraph for any transfer shall not exceed the value of the transferred property required to be included in the gross estate; * * *

Treasury Regulations 80 (1934 Ed.):

ART. 44. *Transfers for public, charitable, religious, etc., uses.*—Deduction may be taken of the value of all property transferred by will or by the decedent in his lifetime not to exceed the value of the transferred property required to be included in the gross estate if in either case the property was transferred * * * (2) to or for the use of any corporation or association organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes (including the encouragement of art and the prevention of cruelty to children or animals), if no part of the net earnings of the corporation or association inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation; * * *

* * * * *

If the decedent died after 5 p. m., eastern standard time, June 6, 1932, and under the terms of the will, or the law of the jurisdiction wherein the estate is administered, or the law of the jurisdiction imposing the particular tax, the Federal estate tax (including the additional estate tax imposed by the Revenue Act of 1932), or any estate, succession, legacy, or inheritance tax is payable in whole or in part out of any bequest, legacy, or devise deductible under section 303 (a) (3), the sum deductible is the amount of such bequest, legacy, or devise so reduced. Thus, if $50,000 is bequeathed for a charitable purpose and is subjected to a State inheritance of $5,000, the amount deductible is $45,000; or if a life estate is bequeathed to

an individual with remainder over to a charitable corporation, and by the local law the legacy tax upon the life estate is taken out of the corpus with the result that the charitable corporation will be entitled to receive only the amount of the fund less the tax, the deduction is limited to the present worth, as of the date of the testator's death, of the remainder of the fund so reduced; or if the testator bequeaths his residuary estate, or a portion thereof, to charity, and his will contains a direction that certain inheritance taxes, otherwise payable from legacies in respect to which they were laid, shall be payable out of such residuary estate, the deduction may not exceed the bequest to charity thus reduced pursuant to the direction of the will; or if a residuary estate, or a portion thereof, be bequeathed to charity, and by the local law the Federal estate tax is payable out of the residuary estate, the deduction may not exceed that portion of the residuary estate bequeathed to charity as reduced by the Federal estate tax. * * *

## APPENDIX B

H. Rep. No. 708, 72d Cong., 1st Sess., pp. 49–50 (1939–1 Cum. Bull. (Part 2) 457, 492):

SECTION 807. DEDUCTION OF BEQUESTS, ETC., TO CHARITY.

The purpose of this amendment is to limit the deduction for charitable bequests, etc., to the amount which the decedent has in fact and in law devised or bequeathed to charity. Under existing law no consideration can be given to any estate, succession, legacy, or inheritance taxes imposed with respect to a decedent's estate even though by the terms of his will or the local law they actually reduce the amount of such bequest or devise. It is evident that where the decedent gives his residuary estate to charity, but by his will directs that such taxes shall be paid therefrom, all that he gives to charity and all that charity is entitled to receive is the residuary estate reduced by the amount of the taxes charged against it; the residuary estate being what is left after the subtraction of such taxes and other charges and prior bequests. This is equally true where, in the absence of such a direction in the will, such taxes under the local law are payable out of the residuary estate.

This amendment restores the sentence appearing in sections 303 (a) (3) and 303 (b) (3) of the revenue act of 1924, which was retroactively repealed by section 323 of the revenue act of 1926.

The Supreme Court on February 18, 1924, in the case of *Edwards* v. *Slocum* (264 U. S. 61), held that, as a matter of construction, a residuary gift to charity was not to be reduced by the Federal estate tax which was imposed on so much of the estate as the testatrix had bequeathed to individuals. Under the State law the estate tax was payable generally out of the estate and so fell upon and reduced the residuary estate given to charity. As a legislative reversal of the decision in that case, the sentence referred to was incorporated in the revenue act of 1924 and covered Federal estate taxes as well as State inheritance taxes where, either by the terms of the will or by the local law, any such tax operated to reduce the amount given to and received by charity. In view of the retroactive repeal of the sentence, the Treasury took the position that the legislative intent thereby indicated necessarily extended both to the Federal estate tax and to State inheritance taxes.

Under the existing law, most absurd results are reached. Thus, if a testator gives his residuary estate to charity and directs that the Federal estate tax and the State inheritance taxes shall be paid out of such estate, the result may be that nothing is left for charity. In such case, notwithstanding nothing is given to charity and charity receives nothing, still there must be deducted from the gross estate a wholly fictitious sum, namely, what he would have given to charity had he not directed otherwise. The result in all other cases to which the amendment will apply varies from the foregoing example in degree only.

S. Rep. No. 398, 68th Cong., 1st Sess., p. 35 (1939–1 Cum. Bull. (Part 2) 266, 290):

> * * * A sentence has been inserted in paragraph (3) [of subdivision (a)] and in paragraph (3) of subdivision (b) to make it clear that the amount deductible under these paragraphs on account of bequests, legacies, or devises for the specified benevolent purposes shall be the net amount distributable for such purposes, after estate, legacy, or inheritance taxes imposed in respect thereof have been deducted therefrom. It is evident that if a testator leaves a residuary estate of $1,000,000 to a charity, but the estate taxes payable out of the residue reduce the amount actually distributed to the charity to $950,000, only the latter amount should be deductible, in computing the amount of the net state, as a bequest to charity. This sentence so provides.

H. Conference Rep. No. 844, 68th Cong., 1st Sess., pp. 25–26, (1939–1 Cum. Bull. (Part 2) 300, 308):

> * * * An additional sentence has been added to these paragraphs to provide that the amount deductible under such paragraphs on account of bequests, legacies, devises, or transfers for the specified benevolent purposes shall be the net amount distributable for such purposes after estate, legacy, or inheritance taxes imposed in respect thereof have been deducted therefrom.

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